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No. 17-494

In the Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC.; OVERSTOCK.COM, INC.; and NEWEGG, INC.,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of South Dakota

BRIEF FOR COLORADO AND 34 OTHER STATES AND THE DISTRICT OF COLUMBIA AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Should this Court abrogate the physical-presence rule of *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967)?

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are 35 States and the District of Columbia—all jurisdictions that, like Petitioner, rely on some form of consumption taxes to fund their essential government operations. The *amici* States have a significant interest in seeing that the unprincipled physical-presence rule receives the "complete burial it justly deserves." *Quill*, 504 U.S. at 321 (White, J., concurring in part and dissenting in part). As the volume of Internet-based retail transactions continues to compound daily, the physical-presence rule exacts an ever-increasing toll on the States' fiscal health. One estimate puts the States' lost tax revenue due to the physical-presence rule at $211 billion over the next five years. Pet. 13. The "States' education systems, healthcare services, and infrastructure are weakened as a result." *Direct Mktg. Ass'n v. Brohl ("DMA")*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring). Equally important, the physical-presence rule intrudes on the sovereign authority of the States. If, as many Justices of this Court have pointed out, the rule is contrary to the Constitution, it amounts to an illegal imposition on the legitimate power of the States, and it provides no justification to strip them of the most effective and sensible methods of sales and use tax collection. Removing those collection methods not only harms the States' budgets but also the Founders' constitutional design.

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[1] No counsel for any party authored this brief in whole or in part, nor did such counsel or any party make any monetary contribution intended to fund the preparation or submission of this brief. Consistent with Rule 37.2(a), the *amici* States provided timely notice to the parties' attorneys more than ten days in advance of filing.

The *amici* States thus strongly support Petitioner's request for the Court to grant certiorari to expeditiously revisit *Quill*'s physical-presence rule.

SUMMARY OF THE ARGUMENT

The Commerce Clause encourages "the free flow of commerce across state lines." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 206 (1994). But this Court has recognized that the Clause does not render interstate or remote retailers immune from reasonable State regulation. "Even interstate business must pay its way." *W. Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938) (internal quotations omitted). The aim is to promote "free competition from *every* producing area in the Nation," *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 539 (1949) (emphasis added), not preferential treatment for either local economic interests *or* those operating from distant computer screens.

The problem with the physical-presence rule is that it was first conceived of in 1967, two years before the moon landing and decades before the first retail transaction occurred over the Internet. *See Nat'l Bellas Hess*, 386 U.S. 753 (1967). The rule is therefore not responsive to the "far-reaching systemic and structural changes in the economy" caused by the Internet. *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring). If anything, the rule impairs rather than advances the Commerce Clause's underlying objective of promoting a free market undisturbed by discriminatory advantages. Today, remote retailers, invoking *Quill*, effectively receive a subsidy because of how unlikely it is that their customers will ever pay the state sales and use taxes that they undeniably owe. *See Direct Mktg. Ass'n v. Brohl ("DMA II")*, 814 F.3d 1129, 1150 (10th Cir. 2016)

(Gorsuch, J., concurring) (recognizing that *Quill* grants remote retailers "favorable treatment, a competitive advantage, a sort of judicially sponsored arbitrage").

The *amici* States are uniquely harmed by the market-distorting effects of the physical-presence rule. Because nearly all of the *amici* States must balance their budgets each year, the loss of tax revenue caused by *Quill*'s rule has forced them to forgo the traditional collection method of requiring the retailer to collect the tax directly from the customer at the point of sale—the procedure that applies to the millions of in-person sales made daily at local stores—and cast about for some kind of workable alternative. But the alternatives tested to date have proved ineffective. The States continue to lose billions of dollars in tax revenue owed on remote retail transactions, despite their attempts to collect the taxes that are undeniably owed. The combined experiences of the States thus demonstrate that direct collection of the tax at the point of sale is necessary to efficiently enforce the States' lawful sales and use taxes.

The negative consequences of *Quill* do not stop with the devastating loss of tax revenue. Because *Quill* is a doctrinal outlier that does not comport with the principles underpinning the Commerce Clause, it has created widespread confusion in lower courts. The result is a fragmented and inconsistent line of authority that has constrained the States' ability to meaningfully respond to the on-the-ground economic realities within the *amici* States' borders. When they have made the attempt, the States have been met with resistance and lengthy *Quill*-related litigation that both stalls the enforcement of legislative measures and costs the States millions in litigation expenses.

Apart from these pragmatic issues, however, there is a more basic problem. *Quill*'s physical-presence rule infringes State sovereignty. This Court has held that the States are sovereign entities entitled to exercise the full extent of their taxing power. It has also affirmed the constitutionality of their complementary sales and use tax schemes. Yet despite these uncontroversial holdings, the physical-presence rule persists, blocking the States from exercising that power fully. It prevents the States from fairly "distributing the burden of the cost of government," including "police and fire protection, the benefit of a trained work force, and the advantages of a civilized society"—all benefits that remote retailers reap when they market their products to the *amici* States' citizens and deliver them packages millions of times per day using the States' infrastructure. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623–24 (1981) (internal quotations omitted).

Suggesting that the States await a national solution from Congress is no answer to this infringement on their sovereignty. This Court invited congressional action nearly 25 years ago to address this issue, yet Congress has repeatedly declined. Moreover, if States have the sovereign authority to require collection by remote retailers, waiting for Congress is an affront to their sovereignty. Federal legislation cannot resolve whether the States have the sovereign authority to collect lawfully imposed sales and use taxes directly from remote retailers. Only this Court can.

REASONS FOR GRANTING THE PETITION

I. The States' collective experience in abiding by *Quill* demonstrates that no substitute is adequate to replace direct collection by the retailer.

The unfairness caused by *Quill*'s physical-presence rule has left the States in an increasingly untenable position. Justice Kennedy highlighted the States' predicament in *DMA*, explaining that "*Quill* now harms States to a degree far greater than could have been anticipated earlier" by causing a "startling revenue shortfall in many States." 135 S. Ct. at 1135 (Kennedy, J., concurring). *Quill*'s rule, Justice Kennedy noted, has not only created "concomitant unfairness" for physically-present retailers, it has also imposed a "serious, continuing injustice" on the States by weakening their education systems, healthcare services, and infrastructure. *Id.* at 1134–35.

Justice Kennedy was of course right. The collective experiences of the *amici* States prove that. In almost each instance, sales and use tax revenue makes up a sizeable portion of the States' budgets.[2] In South Dakota, it accounted for 61 percent of its 2016 general fund; in Colorado, the figure is one third; in

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[2] Of the *amici* States, only Oregon does not impose a general sales-and-use tax. Oregon nonetheless currently has active litigation involving other taxes in which out-of-state vendors responsible for collecting taxes imposed on Oregon consumers allege the protection of *Quill*'s physical-presence rule, such as taxes on the distribution of tobacco products. *See Global Hookah Distribs. v. Dep't of Revenue*, No. TC 5272 (Or. T.C.). This further demonstrates the harm *Quill*'s rule can impose on the States.

Washington, nearly one half.[3] And while taxable E-commerce transactions are steadily increasing, sales and use tax collection actually *decreased* in Colorado from 2008 to 2010. Brief for Respondent at 5–6, *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (No. 13-1032) (citing record). This decrease occurred during the Great Recession when the States' annual budget shortfalls were mounting. *Id.* at 6. The shortfall came at the worst possible time. When the economy falters, the demand for public services goes *up*, increasing both the need for critical government services and the strain on the States' budgets. *Id.* Eliminating the confusion and uncertainty over collecting the owed but almost-never-paid use tax due on remote retail transactions could help fill this void.[4] Colorado alone lost an estimated $170 million of tax revenue owed in 2012 on remote E-commerce transactions. *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring). Texas lost $870 million that year; in California, the estimated number was $1.9 *billion*. Donald Bruce, et al., *State and Local Sales Tax Revenue Losses from e-Commerce*, 50 ST. TAX NOTES 537, 545 (2009) (Table 5). The reason is *Quill*.

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[3] S.D. Bureau of Finance & Mgmt., *Revenue Forecasts*, p. 1 (March 2015), https://tinyurl.com/yasyeot5 (last visited Oct. 11, 2017); Brief for Respondent at 5, *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (No. 13-1032); Wash. Economic & Revenue Forecast Council, *Washington State Economic and Revenue Forecast*, p. 50 (Sept. 2017), https://tinyurl.com/ya95n6m4 (last visited Oct. 11, 2017).

[4] The United State General Accounting Office estimates that individual taxpayer compliance with the use tax is between zero and five percent, excluding motor vehicle sales. U.S. General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, p. 35 (June 2000), https://tinyurl.com/y6uk7fzf (last visited Oct. 3, 2017).

Against this backdrop, *Quill*'s artificial rule has forced the States to craft special regulations to attempt to slow the loss to their treasuries. The result is that, despite the Commerce Clause's purpose of avoiding discriminatory treatment between intrastate and interstate markets, the States are forced to treat differently retailers that maintain a traditional physical presence within their boundaries and national remote retailers that do not. *See* John A. Swain & Walter Hellerstein, *The Questionable Constitutionality of Amazon's Distribution Center Deals*, 62 ST. TAX NOTES 667, 667 (Dec. 5, 2011) (stating States are "effectively force[d] to discriminate against local commerce" under *Quill*).

Colorado, for instance, enacted a notice and reporting law in 2010 that is akin to the IRS W-2 information return for employee income. COLO. REV. STAT. § 39-21-112(3.5) (2017). It requires remote retailers that "do[ ] not collect Colorado sales tax" to (1) provide notice to customers of their obligation to pay the owed sales or use tax directly to the State, and (2) supply the taxing authority with an annual statement specifying the amount of tax owed by each customer.[5] *See id.* In other words, it applies special rules to only those retailers that lack a traditional physical presence in Colorado. Retailers with such presence in the State, while not subject to the notice and reporting law, remain subject to the traditional obligations associated

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[5] Other States have also enacted laws similar to Colorado's. *See* KY. REV. STAT. ANN. § 139.450 (2017); OKLA. STAT. ANN. tit. 68, § 1406.1 (2017); S.C. CODE ANN. §§ 12-36-2692 & 2691(E) (2017); S.D. CODIFIED LAWS § 10-63-1, *et seq.* (2017); TENN. CODE ANN. § 67-6-515(f) (repealed Jan. 1, 2014); VT. STAT. ANN. tit. 32, § 9783 (2017).

with collecting and remitting the sales tax. *Quill*'s physical-presence rule is the sole reason for this unnecessary, differential treatment of retailers that sell identical products to similarly-situated customers.

Although Colorado's innovative notice and reporting law is estimated to chip away at the State's growing "tax gap" caused by *Quill*, it remains only a partial solution. Colorado's law is expected to close its use tax gap by 60 percent at most.[6] It thus does not solve the growing problem caused by the increasing prevalence of remote purchases.

Colorado's approach is only one of a myriad of half-solutions that the States have been forced to devise to attempt to address the harm caused by *Quill*. Other State approaches abound:

- **Bright Line Economic Presence Standard**: Like South Dakota, some States have enacted laws establishing a bright line economic presence standard for determining whether a retailer lacking traditional physical presence must nonetheless collect the State's sales tax.[7] These laws generally provide that a remote retailer is required to collect and remit sales tax if it makes sales in the State exceeding a certain dollar threshold or enters into a certain number of retail transactions for delivery into the State. As

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[6] Brief for Respondent at 9, *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (No. 13-1032) (citing record).

[7] S.D. CODIFIED LAWS § 10-64-2 (2017); *see also* ALA. ADMIN. CODE R. 810-6-2-.90-.03 (Supp. 2016); TENN. COMP. R. & REGS. 1320-05-01-.129 (2017); VT. STAT. ANN. tit. 32, § 9701(9)(F) (2017); WYO. STAT. ANN. § 39-15-501 (2017).

demonstrated by the South Dakota Supreme Court's decision here, the enforceability of these laws remains constitutionally uncertain so long as *Quill* remains on the books. This approach thus does not fix the States' collective dilemma absent action by this Court to abrogate *Quill*.

- **"Click-through nexus" statutes**: Several States have enacted laws that impose collection and reporting duties on remote retailers who market their products using in-state affiliates, including through websites that link to the seller's website.[8] State supreme courts, however, are split over the legality of these statutes. *Compare Performance Mktg. Ass'n v. Hamer*, 998 N.E.2d 54 (Ill. 2013) (striking down Illinois' click-through nexus law under the Internet Tax Freedom Act), *with Overstock.com, Inc. v. State Dep't of Taxation & Fin.*, 987 N.E.2d 621 (N.Y. 2013) (upholding New York's click-through nexus law against Due Process and Commerce Clause challenges). And online retailers have undercut the effectiveness of these statutes by severing ties with their affiliates in States with click-through laws and then claiming *Quill*'s protection.[9]

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[8] CAL. REV. & TAX. CODE § 6203(c)(5)(A) (Deering 2017); CONN. GEN. STAT. § 12-407(a)(15)(A)(x) (2017); GA. CODE ANN. § 48-8-2(8)(M)(i) (2017); KAN. STAT. ANN. § 79-3702(h)(2)(C) (2017); ME. REV. STAT. tit. 36, § 1754-B(1-A)(C) (2017); MINN. STAT. § 297A.66.Subd.4a.(b) (2017); MO. REV. STAT. § 144.605(2)(e) (2017); N.Y. TAX LAW § 1101(b)(8)(vi) (2017); N.C. GEN. STAT. § 105-164.8(b)(3) (2017); R.I. GEN. LAWS § 44-18-15(a)(2) (2017).

[9] *See* Laura Mahoney, et al., *States See Little Revenue From Online Sales Tax Laws, Keep Pressure on Congress*, Bloomberg BNA (Jan.

- **Streamlined Sales and Use Tax Agreement** ("SSUTA"): Twenty-four States participate as members in SSUTA. That effort attempts "to find solutions for the complexity in state sales tax systems that resulted in the U.S. Supreme Court holding[s]" in *Bellas Hess* and *Quill*.[10] Its main features are the availability of a state-level administrator for sales and use tax collection and a uniform tax rate statewide. While SSUTA has eased the burden of collection—for example, by making tax software available to vendors free of charge, Pet. 30—difficulties remain. Joining SSUTA is prohibited in some States because of provisions in their constitutions that grant localities the right to administer their own sales and use taxes. *See, e.g.*, COLO. CONST. art. XX, § 6; IDAHO CONST. art VII, § 6; LA. CONST. art. VI, § 29. More fundamentally, SSUTA's effectiveness is limited by the fact that *Quill* makes vendor participation voluntary. In over seven years, a mere $1.3 billion was collected by retailers registered with SSUTA—a disappointingly low amount compared to the overall $66 billion-plus owed on remote E-commerce sales in the participating States.[11]

8, 2014), http://tinyurl.com/zvaarcv (last visited Sept. 27, 2017) (stating North Carolina "most likely lost revenue because many retailers cut ties with affiliate marketers in the state").

[10] *About Us: The Streamlined Sales Tax Governing Board*, Streamlined Sales Tax Governing Board, Inc., http://tinyurl.com/gtqcdoj (last visited Sept. 27, 2017).

[11] Mahoney, *supra* note 9; Bruce, 50 ST. TAX NOTES at 543 (Table 3, estimating sales and use taxes due on E-commerce in SSUTA participating States at $66.7 billion between 2007 and 2012).

- **"Look up" Table:** Nine States permit taxpayers to estimate their use tax liability by using a percentage of their income found in a "look up" table.[12] But compliance rates in States employing this approach are uneven at best. *See* Lila Disque & Helen Hecht, *Beyond Quill and Congress: The Necessity of Sales Tax Enforcement and the Invention of a New Approach*, 65 AM. U. L. REV. 1163, 1179–80 (June 2016). In California, for example, this approach yielded compliance on just $249 million out of $6.3 billion in remote sales in one period, a mere four percent of the amount owed.[13]

- **Use Tax Line on the Income Tax Return:** Approximately 25 States encourage taxpayers to voluntarily report their use tax liability by including a use tax line on their state income tax return form.[14] Taxpayers' voluntary participation in this approach, however, is paltry, averaging just 1.6 percent.[15]

These varied approaches are just a sampling of how the States have been forced to respond to *Quill* in today's digital era in which "buyers have almost instant

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[12] Nina Manzi, Minn. House of Representatives Research Dep't, *Policy Brief: Use Tax Collection on Income Tax Returns in Other States*, p. 8 (Apr. 2012), http://tinyurl.com/z5fb9sl (last visited Sept. 28, 2017).

[13] California State Board of Equalization, *Revenue Estimate: Electronic Commerce and Mail Order Sales*, p. 7 (Rev. Aug. 2013), https://tinyurl.com/yaelyo72 (last visited Oct. 2, 2017).

[14] Manzi, *supra* note 12, at 2.

[15] Manzi, *supra* note 12, at 9.

access to most retailers via cell phones, tablets, and laptops."[16] *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring). Predictably, many States have also increased the tax rates on their eroding sales tax bases, Pet. 14–15, or been forced to increase other taxes like property or income taxes. Yet despite the States' efforts, no method to date has proven to be an adequate substitute for requiring remote retailers to collect the owed tax at the point of sale.

Nor should this come as a surprise. When a retailer is required to add the owed sales or use tax to the price of the product and collect it at "check out," compliance skyrockets, nearing 100 percent.[17] The Tenth Circuit noted this in Colorado's litigation over its reporting law, explaining that direct collection of the tax yields a 98.3

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[16] This proliferation of varied approaches continues today. Prompted by Justice Kennedy's observation in *DMA* of the "meaningful" and "structural" changes to the economy caused by the Internet, 135 S. Ct. at 1135, several States have recently undertaken a closer examination of today's E-commerce technology and concluded that it *does* include software components that are physically present in the State of the purchaser. *See, e.g.*, OHIO REV. CODE § 5741.01(I)(2)(h) & (i) (2017); R.I. GEN. LAWS § 44-18.2 (2017); 830 Code Mass. Regs. 64H.1.7 (2017). While States adopting this model believe that Internet retailers have physical presence in the State where the purchaser is located, this approach has been challenged under *Quill* and the outcome is uncertain. *See, e.g., Crutchfield v. Harding*, No. CL17001145-00 (Va. Cir. Ct., filed Oct. 24, 2017). These States join this brief because the physical-presence rule creates debilitating uncertainty, without conceding that it immunizes Internet retailers from collection obligations.

[17] Washington State Dep't of Revenue, *2016 Compliance Study*, p. 3 (June 1, 2016) (estimating sales tax noncompliance rate among registered taxpayers at 1.8%), https://tinyurl.com/ycmovp9k (last visited Oct. 2, 2017).

percent compliance rate. *DMA II*, 814 F.3d at 1132 n.1. This is common sense. Direct collection at the point of sale eliminates the need for consumers to keep records of their day-to-day transactions so that they can later report their use tax liability on their individual yearly tax return.

Moreover, in many States, retailers subject to collection and remittance laws are incentivized to properly collect and remit the owed tax. Retailers that comply receive compensation because they are often entitled to retain both a small portion of the tax collected, *e.g.*, COLO. REV. STAT. § 39-26-105(1)(c)(II)(A), and the "net float" interest income earned from investing the tax funds prior to periodic remittance to the State.[18]

Compliant retailers also avoid corrective action by the State—an incentive in and of itself. *Id.* § 39-21-118. But remote retailers that hide behind *Quill* can largely avoid State efforts to penalize them for not collecting the owed tax. Some even go so far as to falsely advertise that the sale is "tax free." Pet.App. 22a. Members of this Court have recognized the problem posed by this unfair, differential treatment. The physical-presence rule enables remote retailers to obtain a "tax shelter" of sorts, contrary to the Commerce Clause's core anti-discrimination principle. *DMA II*, 814 F.3d at 1150 (Gorsuch, J., concurring) (internal quotation marks omitted).

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[18] PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate*, p. 9 (Apr. 7, 2006), https://tinyurl.com/j32k2xt (last visited Oct. 20, 2017).

Quill's effect of forcing the States to revert to different, sub-optimal approaches to solve their resulting tax gaps poses still another problem. The States' disparate answers to *Quill* are, in many cases, incompatible with one another, frustrating the development of more evenhanded and complementary state-specific solutions that can function efficiently across the entire retail market. While click-through nexus statutes and SSUTA jurisdictions are premised on the States collecting the owed tax from the *retailer*, other State approaches use a very different model: voluntary *consumer* remittance. Colorado's information reporting law, "look up" table jurisdictions, and the States that include a use tax line on their income tax return all fall into the latter category. Under that type of patchwork, fastidious consumers who wish to satisfy their tax obligation may unwittingly end up paying the tax twice, while consumers and retailers who are all too happy to avoid compliance pay nothing. The result is a mishmash of different and largely ineffective half-measures that have proven incapable of curing the growing tax gap caused by remote sales. Abrogating the physical-presence rule will allow States to apply their existing collection laws and other enforcement measures in ways that create both a level playing field for in-state and out-of-state retailers and clarity for consumers.

Absent action by this Court, the States will continue to suffer increasing revenue shortfalls at great expense to their essential government functions. Meanwhile, the States' divergent approaches to solving this problem will continue to impose unnecessary complexity on both the retail industry and consumers alike. Accordingly, this Court should grant the Petition to reconsider its decision in *Quill*.

II. *Quill* disrupts the States' right to respond to economic realities and impose lawful taxes in the absence of contrary federal law.

The challenges faced by the States from the physical-presence rule and the uncertainty it creates are not limited to the billions of dollars they lose in tax revenue. The rule also hinders other critical interests of the States, namely their sovereign authority to collect sales and use taxes and their ability to enact meaningful regulatory measures that will pass constitutional muster in the lower courts. Those courts, bound as they are by *Quill*, have struggled to define the proper reach of the physical-presence rule, adversely affecting the States' ability to respond to the economic realities that exist within their boundaries. That problem is all the more confounding because this Court has repeatedly recognized that the States are sovereign entities that may exercise the full extent of the taxing power. *Quill*'s rule interferes with that core aspect of the States' sovereign power, but without doctrinal support under the Commerce Clause.

A. The physical-presence rule is a doctrinal outlier, creating splintered court decisions that hinder the States' ability to pass effective tax enforcement legislation.

The physical-presence rule created by *Bellas Hess* and perpetuated by *Quill* was heavily criticized in 1967, was recognized as a doctrinal mistake in 1992, and causes more harm and confusion in today's Internet age than anyone could have foreseen at the time of either decision.

When *Bellas Hess* first announced the physical-presence rule in 1967, Justice Fortas and two of his colleagues in dissent accurately predicted both the weakness of its doctrinal underpinnings and the resulting injury to state and local economies. He observed that, under any formulation of the dormant Commerce Clause, a commercial enterprise "engaged in the business of regularly, systematically, and on a large scale offering merchandise for sale in a State in competition with local retailers" should not be "excused" from compliance with that State's sales and use tax obligations. 386 U.S. at 765 (Fortas, J., dissenting). Even in 1967—decades before freely available software automated the process—Justice Fortas understood that the alleged mechanical "burdens" of compliance were not enough to justify the doctrinal oddity. In Justice Fortas' view, such objections "vastly underestimate[ ] the skill of contemporary man and his machines." *Id.* at 766. At the very least, he believed that the majority's "haven of immunity" should not be unnecessarily extended to the $2.4 billion national mail-order industry as a whole, but rather only to those few remote retailers that engage in "sporadic or minor" business in a given State. *Id.* at 763. The *Bellas Hess* majority's broad exemption, he forecast, would "be substantial, and ... may well increase in size and importance." *Id.* at 764.

Twenty-five years later, in *Quill*, the Court reaffirmed *Bellas Hess* but on narrower grounds, jettisoning the due process rationale for the physical-presence rule. 504 U.S. 298 (1992). Justice White dissented, criticizing as "without precedent or explanation" the majority's decision to craft a Commerce Clause test in conflict with the standard due process analysis that governs all other jurisdictional boundaries

for state regulation. *Id.* at 327 (White, J., concurring in part and dissenting in part). He also emphasized the compounded inequity visited upon the States and in-state retailers by the majority's "protectionist" rule. *Id.* at 329. What had been a $2.4 billion mail-order industry at the time of *Bellas Hess* had ballooned into a $180 billion industry at the time of *Quill*. *Id.*

The doctrinal confusion created by *Bellas Hess* and continued by *Quill* has left the States in a "harm[ful] and unfair[ ]" position. *DMA*, 135 S. Ct. at 1134 (Kennedy, J., concurring). As a practical matter, state lawmakers are left with no principled method for predicting whether their attempted legislative strategies for mitigating the *Quill* problem will pass constitutional muster. State Attorneys General are hampered in their ability to counsel their government clients, not knowing the contours of *Quill*'s reach in today's modern Internet age. In turn, state tax agencies and rulemaking bodies must fashion rules and provide guidance knowing that their efforts will be challenged in court as violating a rule meant to address the economy as it existed a half-century ago.

The *DMA* case demonstrates this unsustainable trend. Through seven years of costly litigation, the remote retail industry argued that Colorado's information reporting law was an end-run around *Quill*. The lower courts were understandably puzzled, unsure whether and to what extent *Quill* might bar Colorado's attempt to impose obligations that are similar to, but distinct from, those that *Quill* rendered off limits. After three appellate reversals involving two different preliminary injunctions in both state and federal court, the Tenth Circuit finally provided the last word: the

"exceptional narrowness" of *Quill*'s "ratio decidendi" is rooted in stare decisis only, and thus does not bar the States from enacting "other comparable regulatory and tax duties[.]" *DMA II*, 814 F.3d at 1149, 1151 (Gorsuch, J., concurring), *cert. denied*, 137 S. Ct. 591 (2016).

But this narrow reading of *Quill* still has at least two shortcomings. *First*, it is based on a doctrinal anomaly that does nothing to advance the Commerce Clause's overarching objective of promoting a market undisturbed by preferential advantages. Even under the Tenth Circuit's narrow reading of *Quill*, the decision continues to mandate at least some differential treatment of in-state brick-and-mortar retailers versus retailers that lack a traditional physical presence, thus conferring at least some advantage on one over the other.

Second, the Tenth Circuit's narrow interpretation of *Quill* has not been uniformly shared by other courts. To the contrary, the lower courts are divided over the proper scope of the physical-presence rule. *See Lanco, Inc. v. Director, Div. of Taxation*, 908 A.2d 176, 177 (N.J. 2006) (noting split). While some courts like the Tenth Circuit decline to extend *Quill* beyond the narrow sales and use tax context presented by that decision, *see, e.g.*, *In re Various Applicants for Exemption from Prop. Taxation*, 313 P.3d 789, 797 (Kan. 2013); *Scholastic Book Clubs, Inc. v. Farr*, 373 S.W.3d 558, 562–65 (Tenn. Ct. App. 2012); *Scholastic Book Clubs, Inc. v. Comm'r of Revenue Servs.*, 38 A.3d 1183, 1199–1200 (Conn. 2012); *Geoffrey, Inc. v. Comm'r of Revenue*, 899 N.E.2d 87, 94–95 (Mass. 2009); *Tax Comm'r v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 232 (W. Va. 2006), others courts have expanded *Quill* to

reach not only sales and use taxes but other types of taxes as well. *See, e.g., Scioto Ins. Co. v. Okla. Tax Comm'n*, 279 P.3d 782, 784 (Okla. 2012) (citing *Quill* to invalidate income tax imposed on an out-of-state corporation that received payments for its intellectual property used at in-state restaurants); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 299–300 (Tex. Ct. App. 2000) (using *Quill* to invalidate franchise tax imposed on a company holding a certificate of authority to transact business in the State); *J.C. Penny Nat'l Bank v. Johnson*, 19 S.W.3d 831, 841–42 (Tenn. Ct. App. 1999) (using *Quill* to invalidate tax imposed on a bank's income generated by its credit card activities in the State).

These splintered court decisions highlight the confusion and unfairness of *Quill*'s unworkable rule. Retailers, individual taxpayers, and the States all suffer as a result. Their ability to predictably anticipate their tax-related responsibilities and revenues depends entirely on the jurisdiction they happen to occupy rather than the consistent application of a clear legal standard. Maintaining the physical-presence rule will only further perpetuate legal uncertainty, depressing both business activity and resulting tax revenue for the States. *See* Iain MacNeil, *Uncertainty in Commercial Law*, 13 EDINBURGH L. REV. 68, 69 (2009) ("[B]usiness activity is facilitated by legal certainty").

This inconsistency in the lower courts also demonstrates that the purported virtues of maintaining *Bellas Hess*'s supposed bright line—predictability and the reduction of litigation—have never been realized. *See Quill*, 504 U.S. at 329–30 (White, J., concurring in part and dissenting in part) (predicting that it is "very

doubtful" that the majority's goal of reducing litigation will be accomplished). Far from reducing court battles by establishing a clear rule, *Bellas Hess* and *Quill engender* litigation in the E-commerce era, costing the States billions of dollars in litigation expense and lost tax revenue. Part of the reason is that the advent of the Internet has fundamentally altered what it means to be physically present—"a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring). But changes in technology should not force States to spend seven years in litigation, as Colorado did, before they are permitted to chip away at the tax gap problem that *Bellas Hess* and *Quill* created. Indeed, because *Bellas Hess* was likely "wrong when the case was decided," *id.* at 1134, the States should not be forced to cast about for half-solutions in the first place.

Accordingly, this Court should grant certiorari to abrogate *Quill*'s unworkable exemption.

B. The States are sovereign entities that are constitutionally empowered to require remote retailers to collect use taxes.

No one disputes that the States may lawfully impose a use tax on goods that are stored, used, or consumed in a State when sales tax has not already been collected. *See, e.g.*, COLO. REV . STAT. § 39-26-202 (2017). This Court has repeatedly recognized the constitutionality of the States' complementary sales and use tax schemes. *See Henneford v. Silas Mason Co.*, 300 U.S. 577, 584 (1937). The use tax "put[s] retailers subject to the sales tax on a competitive parity with out-of-state retailers exempt from the sales tax." *Nat'l Geographic Soc'y v.*

Cal. Bd. of Equalization, 430 U.S. 551, 555 (1977). The complementary framework is "intended to effect equality." *Henneford*, 300 U.S. at 585. It renders all tangible property used or consumed in a State subject to a uniform tax, regardless of whether it was acquired within or without the State. *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 66 (1963).

But *Quill* thwarts the States' legitimate authority to fully implement and enforce their otherwise lawful sales and use taxes. It frustrates the very principle of State sovereignty that underlies the federal system. *M'Culloch v. State of Maryland*, 17 U.S. 316, 429 (1819) ("All subjects over which the sovereign power of a state extends, are objects of taxation."). "In our federal system, the National Government possesses only limited powers; the States and the people retain the remainder." *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2577 (2012). With taxation in particular, Alexander Hamilton emphasized the importance of the States' sovereignty as early as 1788, stressing the "justness" of the States "possess[ing] an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." THE FEDERALIST NO. 32 (A. Hamilton). "An attempt on the part of the national government to abridge them in the exercise of [their taxing power] would be a violent assumption of power, unwarranted by any article or clause of its Constitution." *Id.* Thus, so long as other constitutional requirements are satisfied, *see Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), it makes no sense, doctrinally or practically, to maintain a special carve-out from the States' sovereign authority. *Cf. DMA II*, 814 F.3d at 1151 (Gorsuch, J., concurring) (noting *Quill* is "surrounded by a sea of contrary law").

While proponents of *Quill*'s artificial physical-presence rule will undoubtedly urge this Court to await a solution from Congress, that familiar argument ignores our system of dual sovereignty. Under that system, "the determination [regarding the appropriateness of a tax] is to be made by the state legislatures in the *first instance*[.]" *Commonwealth Edison*, 453 U.S. at 628 (emphasis added). And here, 35 legislatures in the *amici* States and the District of Columbia have spoken, choosing to enact a lawful sales tax on all retail transactions, including E-commerce transactions. Enforcement of those legislative decisions, however, is significantly obstructed by *Quill*, contrary to our federal scheme. *Cf. Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 444 (1944) (stating that a "practically effective device [is] necessary in order to enable the state to collect its tax"); *see also Dows v. City of Chicago*, 11 Wall. 108, 110 (1871) (stating "the modes adopted to enforce the taxes levied should be interfered with as little as possible").

Forcing the States to negotiate a legislative solution from Congress in lieu of fully exercising the sovereign authority that the Constitution already grants them fundamentally alters our democratic design. Pet. 28. It transforms the States from sovereign entities that are able to respond to the economic realities within their borders into 50 separate Congressional lobbying firms. It wrongly requires them to pursue policy objectives in conference rooms in Washington, D.C., rather than in their respective state legislative chambers where they are answerable to their voters.

This Court should grant review to abrogate the unprincipled physical-presence rule of *Quill*, making

clear that the Commerce Clause is no bar to the States' sovereign authority to collect lawfully imposed sales and use taxes directly from remote retailers. Congress cannot settle that constitutional dispute and, so far, it has been unable or unwilling to address the problem through legislation, despite this Court taking the unusual step of affirmatively inviting Congressional action 25 years ago. *See Quill*, 504 U.S. at 318. In light of Congress' continued inaction, certiorari should be granted by this Court. It is "unwise to delay any longer a reconsideration of the Court's holding in *Quill*." *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring).

CONCLUSION

For the foregoing reasons, this Court should grant South Dakota's Petition for Writ of Certiorari.

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